87-2082

No. 87- .....

In the Supreme Court

OF THE

United States

OCTOBER TERM 1987

MACARTHUR COMPANY and WESTERN MACARTHUR COMPANY,
Petitioners,

VS.

JOHNS-MANVILLE CORPORATION, MANVILLE CORPORATION, et al.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Does a bankruptcy court have jurisdiction to enjoin permanently a nondebtor from making its independent contractual claims against nondebtor insurance companies under a vendor endorsement to a debtor's insurance policy?

2. Does a bankruptcy court have jurisdiction to authorize a debtor to extinguish the contractual claims of a nondebtor against another nondebtor without giving the complaining nondebtor priority over general unsecured creditors?

3. May a bankruptcy court determine a nondebtor's state law rights in a summary proceeding and without applying state law?

LIST OF PARTIES AND RULE 28.1 LIST

The parties to the proceedings below were the petitioners MacArthur Company and Western MacArthur Company and the respondents Johns-Manville Corporation, Manville Corporation, Manville International Corporation, Manville Export Corporation, Johns-Manville International Corporation, Manville Sales Corporation, f/k/a Johns-Manville Sales Corporation, successor by merger to Manville Buildings Materials Corporation, Manville Products Corporation and Manville Service Corporation, Manville International Canada, Inc., Manville Canada, Inc., Manville Investment Corporation, Manville Properties Corporation, Allan-Deane Corporation, Ken-Caryl Ranch Corporation, Johns-Manville Idaho, Manville Canada Service Inc., and Sunbelt Contractors, Inc.

Pursuant to Rule 28.1, petitioner MacArthur Company, a Minnesota corporation, is the parent of petitioner Western MacArthur Company, a California corporation. Other subsidiaries of MacArthur Company are Milwaukee Insulation Company, a Wisconsin corporation; Energy Panel Structures, Inc., a Minnesota corporation; and Poly- Fab, Inc., a Minnesota corporation. The affiliate of MacArthur Company is Dakota Insulation, Inc., a North Dakota corporation.

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The petitioners MacArthur Company and Western MacArthur Company respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The order approving settlement agreements and containing permanent injunctions of the United States Bankruptcy Court for the Southern District of New York

(Lifland, B.J.) has not been reported. It is reprinted in Appendix A, contained in a separate volume filed concurrently herewith.

The order approving additional settlement agreements and containing permanent injunctions of the United States Bankruptcy Court for the Southern District of New York (Lifland, B.J.) has not been reported. It is reprinted in Appendix B, contained in a separate volume filed concurrently herewith.

The decision of the United States District Court for the Southern District of New York (Knapp, J.) has not been reported. It is reprinted in Appendix C, contained in a separate volume filed concurrently herewith.

The opinion of the United States Court of Appeals for the Second Circuit (Newman, C.J.) is reported at 837 F.2d 89 and is reprinted in Appendix D, contained in a separate volume filed concurrently herewith.

The order of the United States Court of Appeals for the Second Circuit denying petitioners' petition for a rehearing in the Second Circuit Court of Appeals has not been reported. It is reprinted in Appendix E, contained in a separate volume filed concurrently herewith.

JURISDICTION

The opinion of the United States Court of Appeals for the Second Circuit was decided January 19, 1988. The Order of the United States Court of Appeals for the Second Circuit denying petitioners' petition for a rehearing was filed on March 21, 1988.

The jurisdiction of this Court to review the judgment of the Second Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

11 U.S.C. § 105 Power of court.
11 U.S.C. § 363 Use, sale, or lease of property.
11 U.S.C. § 524 Effect of discharge.
11 U.S.C. § 541 Property of the estate.

The text of these statutes is reprinted in Appendix F, contained in a separate volume filed concurrently herewith.

STATEMENT OF THE CASE

MacArthur Company and Western MacArthur Company (hereinafter collectively "MacArthur") were longtime distributors of asbestos and asbestos-containing products manufactured by Johns-Manville Corporation and the related Manville entities named as respondents to this action (hereinafter collectively "Manville"). From 1951 through 1976, Manville had primary product liability insurance coverage from Travelers Indemnity Company and Travelers Insurance Company ("Travelers"). The Travelers policies in effect from July, 1963 through July, 1972 contain vendor endorsements which provide to vendors, including MacArthur, insurance coverage coextensive with that of Manville.

In addition, Manville had during this period excess liability coverage in amounts greatly exceeding the Travelers' coverage. Several excess policies had no aggregate limit. The excess policies adopt the terms of the coverage of the Travelers policies, thereby providing the vendors excess insurance coverage coextensive with that of Manville. Both the primary Travelers policies and the excess policies cover the cost of defense at least up to the limits of liability of the policies. MacArthur maintains, as Manville once did, that Travelers has a duty to defend

claims asserted against insureds even after it has paid in full the underlying per occurrence or aggregate limits. R.I. 649 pp. 38-49.[1]

Beginning in the late 1960's, and with increasing frequency during the 1970's and early 1980's, Manville, together with other asbestos producers, was sued by thousands of individuals and entities claiming health and property damage due to asbestos-related diseases and conditions. Numerous insurance carriers denied or restricted coverage with respect to Manville's asbestos liabilities. Accordingly, in 1980, Manville sued its insurers in a California state court for a declaratory judgment of its rights to insurance. Some of the major complex issues in that massive litigation are the choice of law to be applied to the policies, the insurer's duty to defend, and the time when the asbestos-related bodily injury occurs and "triggers" coverage under the various policies. R.I. 641.

Based upon the increasing number of tort claims filed against Manville and its own projection of its health claim liability through the year 2001 of at least $1.9 billion (R.I. 360, p. 3), Manville filed a petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101, *et seq.,* on August 26, 1982.

Pursuant to 11 U.S.C. § 362, the filing of the Chapter 11 petition automatically enjoined all lawsuits against Manville. Under the rationale that they were necessary for its reorganization, Manville obtained temporary injunctions of actions against Manville's employees, agents and related entities, *Johns-Manville Corp. v. Asbestos Litigation Group (In re Johns-Manville Corp.),* 26 B.R. 420

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[1]Citations in the form "R.I. _____" are to the numbered record items filed with the court below.

(Bankr. S.D.N.Y. 1983), *aff'd,* 40 B.R. 219 (S.D.N.Y. 1984) and its insurers and sureties, *id.* and *In re Davis,* 730 F.2d 176 (5th Cir. 1984). The Bankruptcy Court denied the motion of a number of its co-defendants to extend the stay to actions against them. *GAF Corp. v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 26 B.R. 405 (Bankr. S.D.N.Y. 1983).

One result of the Manville bankruptcy filing was the shifting of product liability suits away from Manville and toward Manville's distributors. Thus MacArthur became the target of more than 7,000 lawsuits based on Manville's tortious conduct. The aggregate dollar amount of the judgments, settlements and defense costs already incurred by MacArthur is staggering, and increasing every day.

Beginning in 1984 and continuing through 1986, Manville negotiated settlement agreements with all of its solvent insurers ("Settlement Agreements"). While the settlement amounts and several settlement terms varied among the 24 Settlement Agreements, each contained provisions requiring an order of the Bankruptcy Court transferring any and all claims with respect to Manville's policies and attaching them solely to the settlement fund created thereunder, releasing the settling insurer from any and all claims, deeming the subject policies exhausted, and enjoining any suit with respect to the policies against the settling insurer (the "Injunction").

The Settlement Agreements were contingent upon Manville obtaining a final court order approving them and issuing the Injunction. Under the Settlement Agreements, approximately $730 million of proceeds was earmarked for the trusts to be created by Manville's plan of reorganization in an attempt to satisfy asbestos claims. That

settlement amount was below the aggregate limits of the policies. R.I. 641, 649. Neither Manville nor the settling insurers ever consulted MacArthur or obtained MacArthur's consent to the compromise of its rights under the endorsements.

By applications dated August 2, 1984 and October 27, 1986, Manville sought Bankruptcy Court approval of the Settlement Agreements. MacArthur filed a timely objection to the Settlement Agreements on the grounds that they compromised MacArthur's direct rights to insurance under the vendor endorsements. MacArthur asserted that because the insurance policies had not been exhausted and further provided a duty to defend, MacArthur retained its claims against the policies as an additional insured. Therefore, the injunction of actions against the settling insurers would deprive MacArthur of its rights.

At the Bankruptcy Court hearing on November 19, 1986 to determine the fairness of the Settlement Agreements, Manville took the position that the Travelers policies were exhausted. R.I. 659, p. 23. There was, however, no testimony that the limits of the excess policies were exhausted or that Travelers' duty to defend had expired. A Manville lawyer in the California litigation[2] acknowledged that he had long been aware of the existence of the vendor endorsements and stated that he did not represent MacArthur's interests under the endorsements during the negotiations with the settling insurers leading to the Settlement Agreements. He did contend, however, that the vendor endorsements were a factor in the negotia-

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[2]Evidence at the hearing consisted of the testimony of Richard Von Wald, Vice President and corporate counsel of Manville, and Curtis M. Caton, outside counsel to Manville. Their testimony generally concerned the issues in the California litigation and the insurance policies.

tions. No evidence offered at the hearing related to the validity of the vendor endorsements or the value of MacArthur's rights thereunder.

MacArthur argued that inasmuch as it was sustaining great losses with respect to liability claims derivative of Manville and such lawsuits were likely to continue for the foreseeable future, it would be significantly harmed by the Injunction. MacArthur asserted that due to the vendor endorsements on the policies it had direct rights against the insurance companies which were being nullified by the Settlement Agreements. In addition, MacArthur questioned the Bankruptcy Court's jurisdiction to change, much less destroy, the contractual relationship between two nondebtors.

The Bankruptcy Court adopted Manville's argument that MacArthur's rights under the policies were "highly speculative" and not "of sufficient substance to justify the requested relief." Because the proceeds of the Settlement Agreements formed the "cornerstone of any reorganization of Johns-Manville," the Court held that the agreements must be approved. The Court implied that MacArthur's rights were adequately protected by the indemnity proof of claim it had filed in the Manville case.

On December 15, 1986, Manville executed an application for approval of an insurance settlement agreement with Columbia Casualty Company and Continental Casualty Company. MacArthur renewed its objection to the Settlement Agreements. No evidentiary hearing was held on this settlement. By orders dated December 18, 1986 and January 14, 1987, all of the Settlement Agreements were approved by the Bankruptcy Court. Upon MacArthur's appeal, the United States District Court for the Southern District of New York, Judge Knapp presiding, summarily affirmed on July 15, 1987.

During the period in which Manville was seeking approval of the Settlement Agreements, it proposed a Second Amended and Restated Plan of Reorganization which was confirmed by the Bankruptcy Court on December 18, 1986 as amended on December 19 and December 23, 1986. *In re Johns-Manville Corp.,* 68 B.R. 618 (Bankr. S.D.N.Y. 1986). The plan creates an asbestos health trust which is largely funded by the insurance settlement proceeds. The plan provides for the Injunction against the settling insurers described above and an injunction of suits against Manville for asbestos-related liability. The claims which otherwise would be asserted against Manville and its insurers are channeled to the trust. The plan classifies all asbestos health claims, including the claims of distributor co-defendants, in one class and the treatment of such claims is not distinguished on the basis of their derivative or direct rights against the insurance policies. R.I. 360, p. 21.

The Second Circuit affirmed the District Court in an opinion reported at 837 F.2d 89 and decided on January 19, 1988. The Second Circuit found that the Bankruptcy Court had jurisdiction to issue the Injunction because the debtor's insurance policies are property of the estate and MacArthur's rights thereunder are completely derivative of Manville's rights as the primary insured. No state law analysis was made. The Court of Appeals then held that the Bankruptcy Court had the authority to approve the settlements and to channel claims arising under the policies to the proceeds of the settlement under 11 U.S.C. §§ 363 and 105(a).

The Court of Appeals decision acknowledges that Manville's "sale" of MacArthur's interest does not fall within the traditional use of the sale and channeling power. Nevertheless, it found the sale appropriate under

the court's broad equitable powers because it is essential to a workable reorganization. Finally, the Second Circuit concluded that MacArthur's remedy was to proceed in the Bankruptcy Court against the insurance settlement proceeds.

MacArthur filed with the Second Circuit Court of Appeals a petition for rehearing which was denied on March 21, 1988.

REASONS FOR GRANTING THE WRIT

I

THE BANKRUPTCY COURT ORDER PERMANENTLY ENJOINING A NONDEBTOR FROM PURSUING ITS INDEPENDENT CONTRACTUAL RIGHTS AGAINST A NONDEBTOR EXCEEDS THE JURISDICTION OF THAT COURT AND IS CONTRARY TO THE STATUTORY LAW AND DECISIONS SET FORTH BY THIS COURT AND OTHER CIRCUITS.

Overwhelmed by the enormity of the Manville bankruptcy case, the lower court ignored bankruptcy courts' jurisdictional limitations and granted extraordinary remedies, available only to debtors, to a contractual relationship among nondebtors. Without correction, the Bankruptcy Court's decision, as affirmed by the Second Circuit, will create an untenable exception to the well-established boundaries of bankruptcy court jurisdiction. Such an exception will extinguish the independent rights of nondebtors against nondebtors and contort the limited role of the bankruptcy court.

With the increase in bankruptcy filings of otherwise solvent companies for the purpose of confining present

and future liability caused by mass torts[3], it is likely that Manville's plan of reorganization will become a blueprint for tortfeasor debtors for years to come. There is danger that the precedent set below with respect to MacArthur's contractual rights will go unrectified and be repeated in numerous cases, not limited to mass tort situations, to follow.[4]

While MacArthur does not dispute Manville's right to direct claims against its estate to the trusts, enjoin the pursuit of claims against it or even enjoin the pursuit of claims against the settling insurers by claimants with no direct rights against them,[5] MacArthur vigorously protests Manville's eradication of MacArthur's rights under the vendor endorsements. The vendor endorsements create a separate and direct contractual right of MacArthur against certain of the settling insurers. *Aetna Casualty & Surety Co. v. Martin Surgical Supply Co.*, 689 S.W.2d 263 (Tex. Ct. App. 1985) (vendor endorsement creates in

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[3]Tortfeasor debtors include A. H. Robins Company, Amatex Corporation, Aqua Slide 'n Dive, Pacor, Inc., and Unarco Industries, Inc., among others.

[4]Bankruptcy law publications agree that the confirmation of the Manville plan and approval of the Injunction create a new and worrisome precedent. Broken Bench Review, a publication for bankruptcy lawyers, opens its article on the Manville plan as follows: "Manville Plan And Confirming Order Break New Ground In Reorganization Law. Out Of The Mists Appears 'The Channeling Injunction' — A New Creature Striding Across The Bankruptcy Reorganization World. Innovative Analogy To Sales Free And Clear Of Liens Takes Us 'Beyond Cramdown' Into New Realms Of Delight — Or Terror — Depending On Who Stands In The Way Of The Creature." 6 Broken Bench Review 13 (1987).

[5]*But see Haiges v. Chatz* (*In re Oak Park Cleaners & Dyers, Inc.*), 125 F.2d 420 (7th Cir. 1942) (bankruptcy court does not have the power to protect purchaser of estate's assets after sale).

vendor distinct rights against insurer as additional insured); *Northwestern Mutual Insurance Co. v. Farmers' Insurance Group,* 76 Cal. App. 3d 1031 (Cal. Ct. App. 1978) (additional insureds have the same rights as named insureds). Outside of the bankruptcy context, Manville would not be able, unilaterally or by agreement with the insurer, to deny retroactively MacArthur's rights under the endorsements. *See Shapiro v. Republic Indemnity Co.,* 52 Cal. 2d 437 (1959) (Traynor, J.) (insurer and insured cannot alter rights of beneficiary after injury suffered). Such interference with third parties' contracts should not be sanctioned by the bankruptcy court. *See Callaway v. Benton,* 336 U.S. 132, 142 (1948) (bankruptcy court cannot bind creditor on rights not asserted against the estate).

It has long been recognized that the protections and privileges of the Bankruptcy Code are reserved only for those who make their assets available to creditors and who accept the restrictions and requirements of the court and Code. *First National Bank of Herkimer v. Poland Union,* 109 F.2d 54 (2d Cir. 1940). Therefore it is well-settled that a guarantor cannot be discharged by the bankruptcy discharge of the underlying debt. *Underhill v. Royal,* 769 F.2d 1426 (9th Cir. 1985); *United States v. Stribling Flying Service, Inc.,* 734 F.2d 221 (5th Cir. 1984); *Union Carbide Corp. v. Newboles,* 686 F.2d 593 (7th Cir. 1982), *R.I.D.C. Industrial Development Fund v. Snyder,* 539 F.2d 487 (5th Cir. 1976), *cert. denied* 429 U.S. 1095 (1977); *In re Nine North Church Street, Inc.,* 82 F.2d 186 (2d Cir. 1936). In *Nine North Church Street,* the Second Circuit held:

> By its guaranty, Maryland promised to meet certain obligations and these are not affected by the reorganization of this debtor. Any modification of

> this contract can only be justified by the bankruptcy power which extends only to the relief of insolvent or hard pressed debtors. If Maryland is in that class, it must come into court and establish the fact. It cannot modify its obligations by the reorganization of other insolvents.

Id. at 188. Similarly, the Fifth Circuit stated: "The Bankruptcy Court can affect only the relationships of debtors and creditor. It has no power to affect the obligations of guarantors." *R.I.D.C. Industrial Development Fund v. Snyder,* 539 F.2d 487, 490 n.3 (5th Cir. 1976) (citations omitted).

This basic rule of bankruptcy jurisdiction has been applied to overrule plans enjoining actions against the debtor's predecessors, *Commercial Wholesalers, Inc. v. Investors Commercial Corp.*, 172 F.2d 800 (9th Cir. 1949); enjoining creditors' suits against the debtor's shareholders, *First National Bank of Herkimer v. Poland Union*, 109 F.2d 54 (2d Cir. 1940); discharging the debts of individual partners of a partnership debtor, *Consolidated Motor Inns v. BVA Credit Corp.* (*In re Consolidated Motor Inns*), 666 F.2d 189 (5th Cir. 1982); and releasing the debtor's principal of liability, *Hat-Hanseatische Anlage v. Sago Palms Joint Venture* (*In re Sago Palms Joint Venture*), 39 B.R. 9 (Bankr. S.D. Fla. 1984).

The tenet that a nondebtor's obligations cannot be discharged in bankruptcy is apparent in 11 U.S.C. § 524(e), which provides in pertinent part that "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." This provision was derived without substantive change from Section 16 of the former Bankruptcy Act, which provides, "The liability of a person who is a co-debtor with or guarantor or in any manner a surety for, a

bankrupt shall not be altered by the discharge of such bankrupt." Bankruptcy Act of 1898, 11 U.S.C. § 16 (repealed). All of the former bankruptcy acts contained similar provisions, which are grounded in the well-settled doctrines that a discharge in bankruptcy affects only the personal liability of the debtor and not that of any other person and that a discharge is by operation of law and not by consent of the creditors. 1A J. Moore and J. Mulder, *Collier on Bankruptcy* ¶¶ 16.01-16.02 (14th ed. 1978 & Supp. 1987).

The Second Circuit, following Manville's argument, attempts to distinguish the established jurisdictional doctrine against discharging nondebtors by stating that "the injunctive orders do not offer the umbrella protection of a discharge in bankruptcy. Rather, they preclude only those suits against the settling insurers that arise out of or relate to Manville's insurance policies." *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 91 (2d Cir. 1988). This logic creates a distinction without a difference.[6] Like a discharge, the effect of the Injunction is to protect the settling insurers from any future liability with respect to Manville's tortious conduct. The Injunction is permanent and affects all policy claims. Whatever appellation it is given, the Injunction has the effect of discharging MacArthur's claims against the settling insurers.

The Second Circuit continues, "Moreover, claims against the insurers based on Manville's policies are not extinguished; they are simply channeled away from the

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[6]If the Second Circuit's distinction rests on the fact that the insurers' obligations unrelated to Manville are not released, it should be noted that the overruled plans in the cases cited above released the nondebtors only of liability related to the debtors. MacArthur does not believe that even Manville would attempt to release the insurers of all of their obligations under all of their policies.

insurers and redirected at the proceeds of the settlement." *Id.* As will be discussed further, *infra* at 20, MacArthur would have only theoretical cause to protest this result if it could be assured, or even confident, that all of its indemnity claims and costs of defense would be paid in full by the trust. Unfortunately, Manville offers no such assurances.

MacArthur does not challenge Manville's right to compromise its interest in the policies. It is MacArthur's direct contractual rights against the policies that Manville cannot compromise. Paraphrasing a recent Fifth Circuit decision, the fact that Manville owns the policies does not mean that Manville owns all of the proceeds and rights under the policies. *See Louisiana World Exposition, Inc. v. Federal Insurance Co.* (*In re Louisiana World Exposition, Inc.*), 832 F.2d 1391, 1401 (5th Cir. 1987). The vendor endorsements give MacArthur direct rights against the insurers which Manville does not own and cannot annul. *See Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972) (trustee cannot settle claims of creditors against third parties and confirm a plan releasing such claims).

MacArthur does not dispute that Manville's rights in the policies are property of Manville's estate under 11 U.S.C. § 541. MacArthur does dispute that MacArthur's rights under the policies are property of Manville's estate. Clearly, should the press of asbestos liability suits against MacArthur as a distributor of Manville products force MacArthur into bankruptcy, MacArthur's contractual rights under the Manville policies would be property of MacArthur's estate. *See A.H. Robins Co. v. Piccinin* (*In re A.H. Robins Co.*), 788 F.2d 994 (4th Cir.), *cert. denied* ____ U.S. ____, 107 S. Ct. 251 (1986); *In re Davis*, 730 F.2d 176 (5th Cir. 1984); *Johns-Manville Corp. v. Asbestos*

Litigation Group (In re Johns-Manville Corp.), 26 B.R. 420 (Bankr. S.D.N.Y. 1983), *aff'd*, 40 B.R. 219 (S.D.N.Y. 1984). Therefore, Manville's attempt to sell MacArthur's property should not be sanctioned.

Even if the Injunction is not an impermissible discharge, it was not a proper exercise of a bankruptcy court's authority under 11 U.S.C. § 105.[7] That section, which allows the bankruptcy court to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code, does not delete the traditional required showings for the issuance of an injunction.

No actual showing of irreparable harm or the inadequacy of legal remedies was made and the Bankruptcy Court made no corresponding findings. *Beacon Theatres v. Westover,* 359 U.S. 500 (1959). More important, with respect to MacArthur, Manville did not succeed on the merits. *Sierra Club v. Alexander,* 484 F. Supp. 455, 471 (N.D.N.Y.), *aff'd mem.,* 633 F.2d 206 (2d Cir. 1980). In fact, the merits of MacArthur's rights under the insurance policies were never tried. No briefs were filed or evidence submitted on the state law insurance issues and no justification for the court's conclusion that MacArthur's rights were "highly speculative" was enunciated. Without such a decision on the merits, no permanent injunction should have issued.

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[7]MacArthur questions the bankruptcy court's power to enter the Injunction without MacArthur's consent. Moreover, the Injunction is clearly improper because it is not broad enough to protect the parties whose rights it destroys. Rather than forcing its distributors to defend Manville's tortious conduct, Manville should have extended the Injunction throughout the chain of entities whose liability is solely derivative and left the trusts as the sole fora for Manville asbestos claimants.

The decisions upholding bankruptcy court injunctions prohibiting suits between nondebtors with respect to prepetition claims are limited to preliminary injunctions issued prior to and expiring at the confirmation of a plan. *See A.H. Robins Co. v. Piccinin* (*In re A.H. Robins Co.*), 788 F.2d 994 (injunction of suits against nondebtors proper to allow debtor "breathing room" since plaintiffs can seek relief from the stay at any time); *In re Davis,* 730 F.2d 176 (injunction upheld in part because plaintiff can move for relief from stay). Indeed, injunctions of suits against guarantors, specifically prohibited postconfirmation by the cases cited *supra* at 11, have been issued for the postpetition preconfirmation period. *See Plessey Precision Metals, Inc. v. Metal Center, Inc.* (*In re Metal Center, Inc.*), 31 B.R. 458 (Bankr. D. Conn. 1983), *Seybolt v. Bio-Energy of Lincoln, Inc.,* 38 B.R. 123 (Bankr. D. Mass. 1984). The apparent absence of cases enjoining postconfirmation suits between nondebtors with respect to prepetition claims is evidence that the jurisdiction to do so is limited to the pendency of the Chapter 11 case.

The rationale that an injunction is necessary for or in aid of a reorganization, while sometimes stretched too far, *see Otero Mills, Inc. v. Security Bank & Trust* (*In re Otero Mills, Inc.*), 25 B.R. 1018 (D.N.M. 1982), is justifiable preconfirmation. The line must be drawn once a plan is confirmed. The fact that Manville has crossed that line mandates that certiorari be granted.

Manville erroneously asserts that the Settlement Agreements are justified as a sale free and clear of liens and interests under 11 U.S.C. § 363(f) with interests

attaching to the sale proceeds, *i.e.*, the trusts.[8] Under § 363(f), the debtor may sell property of the estate free and clear of any interest of another entity under certain circumstances. MacArthur asserts that § 363(f) was never intended to apply to the present situation. That section has traditionally been used to authorize the trustee's sale of tangible property subject to liens, as the Second Circuit admitted. In a tangible property situation there is open, competitive bidding, as opposed to closed door negotiations between trustee and "purchaser." The court, trustee and lienholders each have independent means to evaluate the purchase offer and determine whether a reasonable price is being offered. *Ray v. Norseworthy,* 90 U.S. (23 Wall.) 128 (1874); 2 L. King, *Collier on Bankruptcy* ¶ 363.07 (15th ed. 1979 & Supp. 1987). More important, in most cases the value of a lien on tangible property can be readily ascertained. The value of MacArthur's rights as an additional insured can be known only in retrospect after all asbestos health claims have been identified and liquidated. For these reasons, § 363(f) should not be misused to justify the nonconsensual compromise of insurance rights.

Even if § 363(f) is available in non-tangible property situations, it has not been correctly applied in this case. No showing was made that MacArthur's interest as an additional insured is in bona fide dispute, as required by subsection (4). The Second Circuit has erroneously accepted Manville's contention that MacArthur's rights are in dispute merely because the insurance policies are now exhausted. The fallacy in that logic is that the excess policies are only exhausted because the Bankruptcy Court

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[8]During the bankruptcy court hearings on these issues, Manville only mentioned § 363 in passing and never attempted to make any showing to meet its requirements. R.I. 659, pp. 114-16.

deemed them to be exhausted in approving the Settlement Agreements.[9] The insurance companies did not agree to a settlement in which they paid the full amount of their exposure.

In addition, it has been held that subsection (4) only codifies the long-standing law allowing a sale free and clear when the validity of the lien is in dispute. *Richardson v. Pitt County (In re Stroud Wholesale, Inc.)*, 47 B.R. 999, 1002 (Bankr. E.D.N.C. 1985). As the *Stroud* court pointed out, a sale under that subsection is not justified merely because there is a dispute as to the distribution of the proceeds of the sale. *Id.* In the present case, Manville has never disputed the existence or effect of the vendor endorsements.

Moreover, § 363(f) does not allow a sale free and clear of contract rights. The section was only intended to encompass judicial liens, security interests, and statutory liens. *Jandel v. Precision Colors, Inc. (In re Jandel)*, 19 B.R. 415, 419-20 (Bankr. S.D. Ohio 1982) (trustee cannot sell shares of stock free and clear of contractual rights of minority shareholders).

Even if § 363(f) were appropriately applied to MacArthur's rights, the order which indiscriminately "channels" MacArthur's rights in the policies into a pool containing all tort claims against Manville cannot withstand scrutiny. Only MacArthur's "interest" and those of other vendors should be channeled to the settlement proceeds. Once those interests are satisfied, the remaining proceeds

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[9]Manville may erroneously believe that MacArthur's rights under the vendor endorsements are limited to the Travelers policies. Because the excess policies adopt the terms of the Travelers policies, however, MacArthur's rights under the endorsements extend to the full limits of the excess policies.

are available to Manville's creditors. To stretch § 363 so that tort claimants against Manville have direct interests in the insurance policies is not authorized by the statute. *See Volvo White Truck Corp. v. Chambersburg Beverage, Inc. (In re White Motor Credit Corp.)*, 75 B.R. 944 (Bankr. N.D. Ohio 1987) (because tort claimants have no specific interest in a debtor's property, § 363 is inapplicable for sales free and clear of such claims).

Furthermore, MacArthur asserts its direct insurance rights give it ownership rights in the policies. Accordingly, assuming *arguendo* that a claim for insurance can be sold, § 363(h) applies. That section allows for the sale of property co-owned by the debtor under certain conditions. Manville never made a showing that it met those conditions. Nor did it comply with the requirement in § 363(i) allowing MacArthur to participate in negotiations regarding the sales price of MacArthur's rights. Even if Manville had met those conditions enabling it to sell the co-owned property, it would still have had to distribute to MacArthur MacArthur's share of the proceeds before distributing to its creditors Manville's share of the proceeds under 11 U.S.C. § 363(j). The Manville Settlement Agreements and plan did not attempt to accomplish this statutorily mandated result. In practical terms, Manville would have had to segregate the amount of proceeds from the policies at issue and reserve that fund for payment of MacArthur's claims for insurance.

Viewed from another perspective, while MacArthur's liability is admittedly derivative of Manville's liability, MacArthur's rights to the policy proceeds are not derivative due to the vendor endorsements. As such, MacArthur is entitled to priority to the proceeds over other claimants. A claimant releasing a more valuable direct claim (as well as a derivative claim) should be entitled to more

than claimants releasing only derivative claims. *In re AOV Industries, Inc.*, 792 F.2d 1140 (D.C. Cir. 1986).

The Second Circuit found that MacArthur's interests are adequately protected because it retains the remedy of proceeding against the insurance proceeds. 837 F.2d at 94. Such finding is erroneous in that it fails to take into account two factors. First, insurance rights are distinctly different from claims for money. Especially in MacArthur's case, insurance is far more valuable. The major insurance companies involved in this case are more likely to be solvent and providing coverage into the twenty-first century than is the trust. The duty to defend as well as an implied duty to act in good faith, both only applicable to an insurer, are of great import to MacArthur as it continues to fight Manville's battles in state courts, not having been afforded the luxury of an injunction of actions against it.

Furthermore, Manville has consistently declined to make representations that the settlement proceeds or the trust will be able to satisfy all claims against it. R.I. 360, p. 9. In fact, because claims will be paid on a "first-come first-served" basis, there is a fair possibility that the trust will not be able to satisfy claims liquidated against MacArthur several years from now.[10] Therefore, a claim against the proceeds alone, with no insurance coverage, will not assure that MacArthur is fully compensated for the taking of its insurance rights.

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[10]Indeed, at the "Fairness Hearing" Manville characterized the notion that there would be an excess in the trust (then $500 million) after claims are paid as "ludicrous" and "laughable." Manville stated that there was only an "infinitesimal possibility" that a surplus would remain. R.I. 659, p. 32.

In summary, MacArthur has direct nonderivative rights to the insurance benefits and proceeds. Manville's "sale" of those rights is improper under the Bankruptcy Code, especially if the sale does not reserve for MacArthur its undiluted share of the proceeds. More important, the Second Circuit's blessing of the Bankruptcy Court's *de facto* discharge of MacArthur's direct claims against Manville's insurers exceeds the jurisdiction of the bankruptcy court. This Court should review this case to correct the fundamental errors of the Second Circuit and to prevent other circuits from making the same jurisdictional mistakes.

II

PROPERTY INTERESTS CREATED AND DEFINED BY STATE LAW SHOULD NOT BE DETERMINED BY A BANKRUPTCY COURT IN SUMMARY FASHION AND WITHOUT REFERENCE TO STATE LAW.

If a bankruptcy court is allowed to determine the direct property rights that one nondebtor has in an insurance policy issued by another nondebtor in a summary proceeding without reference to governing state law, the myriad of problems once resolved by the *Erie* doctrine are bound to be revisited. MacArthur's rights as an additional insured against the settling insurers involve highly complex factual and legal issues. Yet, the Manville Bankruptcy Court determined that such rights were "highly speculative." This determination was made in the context of a 3½ hour hearing at which virtually no evidence was presented, briefs submitted or argument heard regarding

the underlying insurance issues or applicable state law.[11] Accordingly, it is clear that the Bankruptcy Court's conclusion regarding MacArthur's insurance rights was not based on state law, but rather on its notion of federal equity or federal common law[12]. However well-meaning, the Bankruptcy Court was without power to so act.

Property interests are created and defined by state law. *Butner v. United States,* 440 U.S. 48 (1979). State law can only be rejected because of congressional command or because a federal approach serves an identifiable interest. *Texas Industries, Inc. v. Radcliff Materials, Inc.,* 451 U.S. 630, 641 (1981). Similarly, this Court has observed, "The enactment of a federal rule in an area of national concern, and the decision whether to displace state law in doing so, is generally made not by the federal judiciary, purpose-

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[11]Had the bankruptcy court looked to state law it would have found each and every reported state law vendor endorsement case has recognized the rights of vendor/insureds such as MacArthur. *See Cooper Laboratories, Inc. v. International Surplus Lines Insurance Co.,* 802 F.2d 667 (3d Cir. 1986); *Sears Roebuck and Co. v. Reliance Insurance Co.,* 654 F.2d 494 (7th Cir. 1981); *Sears Roebuck and Co. v. Employers Insurance of Wausau,* 585 F. Supp. 739 (N.D. Ill. 1983); *Liberty Mutual Insurance Co. v. Home Insurance Co.,* 583 F. Supp. 849 (W.D. Pa. 1984); *Mattocks v. Daylin, Inc.,* 452 F. Supp. 512 (W.D. Pa. 1978); *Great Atlantic and Pacific Tea Co. v. Pepsi Cola Bottling Co.,* 209 F. Supp. 629 (E.D. Ill. 1962); *Sears Roebuck and Co. v. Liberty Mutual Insurance Co.,* 199 F. Supp. 769 (N.D. Ill. 1961); *Gamble Skogmo, Inc. v. Aetna Casualty and Surety Co.,* 390 N.W. 2d 343 (Minn. Ct. App. 1986); *Aetna Casualty and Surety Co. v. Martin Surgical Supply Co.,* 689 S.W.2d 263 (Tex. Ct. App. 1985); *American White Cross Laboratories, Inc. v. Continental Insurance Co.,* 202 N.J. Super. 372, 495 A.2d 152 (N.J. Super. Ct. App. Div. 1985); *W. T. Grant Co., Inc. v. USF & G Insurance Co.,* 279 Pa. Super. 591, 421 A.2d 357 (Pa. Super. Ct. 1980).

[12]A similar analysis can be applied to the Second Circuit's conclusion that MacArthur's rights are "derivative."

fully insulated from democratic pressures, but by the people through their elected representatives in Congress." *City of Milwaukee v. Illinois,* 451 U.S. 304, 312-313 (1981) (citation omitted). In order to be uniquely federal and justify the imposition of a federal substantive rule, an interest must relate to an articulated congressional policy or directly implicate the authority and duties of the United States as sovereign. *Texas Industries, Inc. v. Radcliff Materials, Inc.,* 451 U.S. at 641; *Northwest Airlines, Inc. v. Transport Workers Union,* 451 U.S. 77 (1981).

Congress has not made policy on the issue of Manville's insurance coverage. Absent such specific action, the Court of Appeals' contention that the broad equitable powers of a bankruptcy court empowered it to abrogate (without evidence or reference to state law) MacArthur's contractual rights against the settling insurers is wrong. A similar argument was made in *Guaranty Trust Co. v. York,* 326 U.S. 99 (1944) where the plaintiff argued that a federal court's equitable powers and discretion constituted an exception to the *Erie* doctrine. In rejecting that claim, this Court stated:

> [S]ince a federal court adjudicating a State created right solely because of the diversity of citizenship of the parties is for that purpose, in effect, only another court of the State, it cannot afford recovery if the right to recovery is made unavailable by the State nor can it substantially affect the enforcement of the right as given by the State.

Id. at 108-09. In creating courts of equity to preside over reorganization proceedings, Congress never gave, nor have the courts ever claimed, the power to deny substantive rights created by state law or to create substantive rights denied by state law. *Id.* at 105.

That Manville is in bankruptcy court and MacArthur is not should not lead to a difference in the treatment of their respective rights against their common insurers. The source of all substantive rights under the insurance policies is the law of the states. A writ should issue so that MacArthur may fully assert in an appropriate forum its state law rights as an additional insured under the policies.

III

BECAUSE THIS CASE INVOLVES IMPORTANT ISSUES AFFECTING THE ADMINISTRATION OF THE BANKRUPTCY LAWS AND WILL IMPACT MANY PENDING AND FUTURE BANKRUPTCY CASES OF TORTFEASOR DEBTORS AND OTHERS, AN EARLY DECISION ON THESE ISSUES BY THIS COURT IS DESIRABLE.

The approval of Manville's Settlement Agreements and plan, complete with channeling order and Injunction, has made new law and, MacArthur submits, bad law. Because of the end result — the creation of a vehicle to pay some part of asbestos health claims and the continued protection of the debtor — the plan is bound to be imitated often by the growing class of tortfeasor debtors. While the plan offers interesting approaches to new problems, one of the legs upon which it rests is flawed and without correction the Settlement Agreements and plan cannot stand.

There is a real threat that present and future debtors will pick up where Manville left off. Seeing that Manville was upheld in its abrogation of nondebtor-nondebtor contracts, debtors may become more bold and test how far the justification "necessary for the reorganization" can be stretched postconfirmation. The steadily main-

tained case law which denies a bankruptcy court jurisdiction to meddle with nondebtors' rights against one another will be further eroded. In this case only MacArthur and other vendors are prejudiced by the court's excessive reach. In future cases, not only vendors but many other parties, such as shareholders, guaranty-holders and partnership creditors, may be enjoined from pursuing their rights against nondebtors. Manville should not be allowed to start that trend.

As a matter of policy, insurance companies should not be given the message that if they settle with a debtor in bankruptcy court they will be allowed to escape their obligations to other insureds. It is not too outlandish to speculate that a result of such a message could be collusive bankruptcy filings in cases where insurers face substantial exposure. The precedential effect of the Second Circuit opinion will be far-reaching.

This Court has been active and vigilant in demarcating bankruptcy court jurisdiction. *See Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). The present trend of bankruptcy cases allowing debtors free rein as long as actions are in aid of reorganization must be halted. This Court should step in now to assure that the fresh start given to debtors does not become a head start.

CONCLUSION

Based upon the foregoing, MacArthur respectfully requests that its petition for writ of certiorari be granted.

DATED: June 17, 1988

Respectfully submitted,

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PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On June 17, 1988, I served the within Petition for Writ of Certiorari in re: "MacArthur Company and Western MacArthur Company vs. Johns-Manville Corporation" in the United States Supreme Court, October Term 1987, No. 87-.....; and the separately bound Appendix;

On the Parties in said action, by placing Three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States Post Office mail box at Los Angeles, California, addressed as follows:

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All parties required to be served have been served.

I certify, under penalty of perjury, that the foregoing is true and correct.

Executed on June 17, 1988, at Los Angeles, California.

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CE CE MEDINA